

White-Collar Crime

COMMENTARY

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DOJ's Revision of Its Charging Guidelines In Corporate Prosecutions

Major Changes in Tone, Minor Changes in Substance

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In the past four years, the Department of Justice has used aggressive and controversial tactics to battle white-collar crime. Some of these practices, which are embodied in the agency's 2003 "Principles of Federal Prosecution of Business Organizations," also known as the Thompson memo, have seriously eroded both the attorney-client privilege and the work product doctrine in the corporate context. The Thompson memo has urged federal prosecutors to seek privilege waivers from corporations as a condition of receiving credit for cooperating during investigations. It has further denounced the advancement of attorney fees for officers and employees under investigation and indictment, and the memo warned that prosecutors could also weigh that factor in their corporate charging decisions.

These zealous principles have engendered harsh criticism from corporate America, the legal profession, the judiciary, the legislature and even former senior DOJ officials. In the past year, the criminal defense bar successfully challenged the government's implementation of the Thompson memo's attorney fee guidelines in a high-profile case involving KPMG's promotion of tax shelters. In that case a federal court issued two forceful opinions in which it invalidated the government's conduct on constitutional grounds, established a process to ensure KPMG's payment of the defendants' attorney fees, and suppressed statements made by two defendants to prosecutors as coerced and involuntary due to governmental misconduct.

Recently, Republican Sen. Arlen Specter, who was chairman of the Senate Judiciary Committee until recently, introduced

a bill designed to render unlawful several Thompson memo principles, including requests for privilege waivers.

In what appears to be a preemptive attempt to undermine the proposed bill, Deputy Attorney General Paul J. McNulty announced the release of revised corporate charging guidance in white-collar criminal cases Dec. 12. The revamped guidelines, termed the McNulty memo, supersede the Thompson memo. The revisions purport to address the concerns raised about the Justice Department's most criticized principles governing privilege waivers and the advancement of attorney fees.

Now, prosecutors must establish a "legitimate need" for privileged information and obtain the written approval of DOJ supervisors before seeking a waiver. Prosecutors also are barred from considering the advancement of attorney fees as a charging factor except in the "extremely rare case" in which circumstances show that the advancement was intended to impede an investigation.

The DOJ's revision of its guidelines is largely a matter of form over substance. The most significant change is one of tone, in which the McNulty memo pays extensive lip service to the importance of the attorney-client privilege and seeks to promote an alliance between corporate management and the agency to combat corporate fraud. But the substance of the new guidelines effectuates only minor changes to the DOJ's prior policies.

Under the new guidelines, prosecutors can still request that corporations waive their privileges and can still pressure companies to terminate employees under investigation.

These practices continue to threaten both the fairness of the adversary system and the constitutional rights of employees. This article discusses the events leading to the DOJ's modified guidelines, the key revisions of the guidelines and their likely impact on corporate America.

I. The Thompson Memo

Following the corporate scandals of Enron, WorldCom and Arthur Andersen, the Bush administration significantly altered its approach to fighting corporate fraud. It formed the Corporate Fraud Task Force and made the prosecution of white-collar crime a national priority. The Sarbanes-Oxley Act of 2002¹ provided prosecutors with several new weapons to use in prosecuting corporate executives and employees in the form of newly defined crimes and substantially increased statutory fines and prison terms for pre-existing crimes frequently used in white-collar prosecutions such as mail and wire fraud.

Additionally, then-Attorney General John Ashcroft issued a DOJ directive that essentially ordered prosecutors to use the new tough laws and increased penalties of Sarbanes-Oxley. The directive limited prosecutorial discretion in charging decisions and sentence recommendations, requiring federal prosecutors to charge the "most serious, readily provable offense or offenses" that are supported by the facts of the case.²

The DOJ also unleashed perhaps its most cogent weapon: the threat to file criminal charges against corporations. The indictment of a corporation can not only impose serious financial hardship on the company, but it can, in and of itself, also be a veritable death sentence, as evidenced by the swift collapse of Arthur Andersen following its indictment and subsequent conviction in June 2002.³ Additionally, an indictment often has severe collateral consequences, including debarment or exclusion from specified businesses, damage to reputation, loss of key employees, loss of investor confidence, and a decrease in a company's stock price.

Confident that corporate America would seek to avert the dire consequences of an indictment, the Justice Department embraced a strategy designed to induce, if not coerce, companies to cooperate against their executives, officers and employees in white-collar criminal investigations and prosecutions. The linchpin of that strategy was the Thompson memo, issued Jan. 20, 2003.⁴

In his memorandum to DOJ personnel, then-Deputy Attorney General Larry D. Thompson stressed the need for an "increased emphasis on and scrutiny of the authenticity of a corporation's cooperation" in federal criminal investigations. He warned that business organizations

often "take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation," while purporting to cooperate.⁵

The Thompson memo identified nine factors that all U.S. attorneys were obliged to consider in determining whether to file charges against a corporation.⁶ One of those factors was "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents."⁷ In practice, this has been the predominant factor favoring lenient treatment of a corporation.

To gauge the extent of a corporation's willingness to cooperate, prosecutors could consider "the completeness of its disclosure, including, if necessary, a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors, and employees and counsel." The stated rationale was that the waivers "permit the government to obtain statements of possible witnesses, subjects and targets, without having to negotiate individual cooperation or immunity agreements."⁸

The Thompson memo expressly authorized prosecutors to request privilege waivers from corporations in "appropriate circumstances."⁹ While leaving the term "appropriate circumstances" undefined, the memo noted that the waiver "should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue."¹⁰ The Thompson memo counseled prosecutors that they should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation except in unusual circumstances.¹¹

Another key factor to be weighed by prosecutors in assessing a company's cooperation was whether it appeared to be protecting culpable employees and agents by advancing attorney fees, retaining blameworthy employees without sanction or providing information to employees about the government's investigation pursuant to a joint defense agreement.¹² As to the advancement of attorney fees, the guidelines noted that some states require corporations to pay the legal fees of officers under investigation before a formal determination of guilt and that a company's compliance with governing state law should not be considered a failure to cooperate.¹³

Overall, the Thompson memo sent a clear message to corporate America: Cooperate to avoid prosecution. One Justice Department official commented that, "for a corporation to get credit for cooperation, it must help the

government catch the crooks," which may require it to make a "waiver because it has gathered the facts through privileged interviews and the protected work product of counsel."¹⁴

In the past four years, corporate America has responded overwhelmingly to the Thompson memo's admonition by cooperating with the government in white-collar criminal investigations and prosecutions. In several highly publicized cases, outside directors and outside counsel for prominent companies have effectively become *de facto* prosecutors for the Justice Department. They have initiated internal investigations of alleged employee wrongdoing, fired high-profile executives, waived corporate privileges and delivered evidence from their internal probes to federal prosecutors. In turn, the government has used company-gathered evidence as a roadmap to charge corporate executives, while simultaneously deferring prosecution of the companies.

II. Controversy and Backlash Over the Thompson Memo

A. Criticism of the Thompson Memo

The Justice Department's practices under the Thompson memo have sparked sharp and widespread disapproval from corporate America, the judiciary, the legislature and the legal profession. Critics justifiably maintain that a "culture of waiver" has evolved and that "governmental agencies [now] believe that it is reasonable and appropriate for them to expect a company under investigation to broadly waive attorney-client or work product protections."¹⁵

They complain that the DOJ's policies have undermined the corporate attorney-client privilege by discouraging corporate personnel at all levels from consulting with counsel on close issues, which has hampered compliance programs and internal investigations.¹⁶ They further assert that the agency's privilege waiver policy has encouraged excessive "follow-on" civil litigation by providing plaintiffs' lawyers with sensitive and confidential information that can be used in class actions and derivative suits to the detriment of the company's employees and shareholders.¹⁷

The American Bar Association has also emphasized that the DOJ's policies are inconsistent with the fundamental principle that all prospective defendants, including a company's current and former employees, officers, directors and agents, are presumed to be innocent.¹⁸ Contrary to this bedrock tenet of our criminal justice system, the ABA said, prosecutors frequently conclude that certain employ-

ees are culpable before the company has even completed its own investigation and well before any formal adjudication. In such cases, the ABA maintains that prosecutors have pressured companies to fire employees or to refuse to provide them with legal representation as a condition of receiving credit for cooperation.¹⁹

Both the ABA and former senior members of the Justice Department have strongly urged the agency to revise the Thompson memo by preventing prosecutors from requesting privilege waivers as a condition for determining whether an organization has cooperated.²⁰ The DOJ has rebuffed this recommendation and assured critics that, under its guidelines, prosecutors seek privilege waivers only when there is a need for timely, complete and accurate information.²¹

B. Judicial Invalidation of the Thompson Memo's Advancement Guidelines

While interested groups sought to persuade the Justice Department to revamp its policies, the criminal defense bar successfully challenged the constitutionality of the Thompson memo's principles and their implementation this past year in *United States v. Stein*.²² *Stein* involved the indictment of several former KPMG employees on charges related to allegedly illegal tax shelters promoted by the company.

Concerned about an Internal Revenue Service criminal investigation and a congressional inquiry, KPMG retained outside counsel to formulate a "cooperative approach" with the government. During meetings with KPMG's outside counsel, federal prosecutors made it clear that, under federal guidelines, KPMG's payment of legal fees for employees under investigation would be viewed as rewarding their misconduct. Heeding the government's warning, KPMG limited the payment of legal fees for each employee to \$400,000 and conditioned the payment on the employee's willingness to cooperate with the government. KPMG further terminated the payment of legal fees of those employees who were indicted.

The government sought to take full advantage of KPMG's legal fee arrangement and attempted to interview many employees. It encouraged KPMG to press its employees to cooperate and urged the firm to instruct employees to disclose all personal criminal wrongdoing. When an employee balked, prosecutors informed KPMG, which in turn reiterated its threat to terminate payment of legal fees unless the government was satisfied with the employee's cooperation. KPMG gave some employees the ultimatum of cooperating with the prosecutors or being fired. Under these circumstances, the government obtained statements from nine of the defendants.

All the defendants moved to dismiss the indictment, asserting that the government improperly interfered with KPMG's advancement of fees in violation of their constitutional and common-law rights. In a separate motion the nine defendants who made statements to the government moved to suppress those statements on the ground that they were coerced, in violation of their Fifth Amendment privilege against self-incrimination. The U.S. District Court for the Southern District of New York issued separate opinions as to each issue.

In its first opinion, the court held that the government's implementation of the Thompson memo's advancement-of-fees policy violated both the defendants' Fifth Amendment due-process rights and their Sixth Amendment right to counsel.²³ The court made several key factual findings on which it based its ruling.

First, the Thompson memo caused KPMG to consider departing from its long-standing policy of paying attorney fees of its personnel in all cases and investigations even before it met with staff of the U.S. Attorney's Office. Second, due to the threat to the firm inherent in the Thompson memo, KPMG sought the government's indication that it would not hold its settled practice against it; instead, the government reinforced the threat.

Third, the government made clear that KPMG's payment of anything more than compliance with legal obligations would be held against the firm. Fourth, KPMG's decision to cut off payment of legal fees to anyone indicted and to limit and condition payment on cooperation with the government was a direct consequence of the pressure applied by the Thompson memo and the U.S. Attorney's Office.²⁴

One month later the District Court held that the government had coerced two of the nine statements made by the KPMG defendants and issued an order suppressing the statements.²⁵ As to both suppressed statements, the court noted that KPMG, at the government's direction, threatened to fire the employees and cut off payment of their legal fees if they did not cooperate with the government.²⁶

The court concluded that the statements were involuntary because the government coerced KPMG to apply pressure to the two employees to secure waivers of their constitutional rights, which the government itself could not obtain.²⁷ While the Justice Department has appealed the ruling, the decision nonetheless was a major blow to its future reliance on the Thompson memo's advancement of legal fees guidelines.

C. Proposed Legislation to Override the Thompson Memo

In 2006 the Thompson memo became the subject of congressional hearings and proposed legislation designed

to eradicate the memorandum's controversial principles. At a March hearing members of the House Judiciary Subcommittee on Crime, Terrorism and Homeland Security expressed support for preserving the attorney-client privilege and voiced serious concerns regarding the Justice Department's waiver policy.²⁸

In September outgoing Senate Judiciary Committee Chairman Arlen Specter, a vocal critic of the Thompson memo, convened a hearing about the memo's effect on the right to counsel in corporate investigations. Specter and ranking member Patrick Leahy, the Vermont Democrat who now chairs the committee, both declared that the DOJ's reliance on the Thompson memo was eroding the attorney-client privilege.

Former Attorney General Edwin Meese III endorsed this position and highlighted the government's conduct in *United States v. Stein* to demonstrate his point.²⁹ Meese advocated that the DOJ eliminate any reference to the waiver of attorney-client privilege or work product protections in the context of determining whether to indict a business organization.³⁰

Deputy Attorney General Paul McNulty vigorously defended the Thompson memo's provisions. He downplayed the significance of privilege waivers by characterizing the waiver as only one "sub-factor or element" that a prosecutor may weigh in assessing the adequacy of a corporation's cooperation.³¹ He further dismissed criticism of the DOJ's privilege waiver practice, saying it "tend[s] to distort its importance in the overall charging decision by inaccurately describing waiver as essential or the only thing prosecutors consider." McNulty emphasized that "a corporation that chooses not to waive the privilege will not necessarily be charged."³²

As to the Thompson memo's advancement-of-fees provision, he also sought to minimize the importance of this factor by saying it is only a "small part of the overall assessment as to whether a corporation cooperated."³³

Unsatisfied with the DOJ's position, Specter indicated that if the agency did not revise the Thompson memo, legislative action would follow.

Less than three months later Specter introduced a bill called the Attorney-Client Privilege Protection Act of 2006, which was then referred to the Senate Judiciary Committee.³⁴ And because he believes the subsequent McNulty memo, like its predecessor, "discourages corporate employees from having frank conversations with lawyers," Specter reintroduced the bill to the Senate when Congress convened Jan. 4.³⁵

The express “purpose” of the bill is to impose limits on each governmental agency “designed to preserve the attorney-client privilege and work product protections available to an organization and preserve the constitutional rights and other legal protections available to employees of such an organization.”³⁶

It begins by setting forth nine congressional findings, many of which directly attack the Justice Department’s privilege waiver policy and echo the reasoning of the court in *Stein*. For example, one finding expressly concludes that the DOJ has “employed tactics that undermine the adversarial system of justice, such as encouraging organizations to waive attorney-client privilege and work product protections to avoid indictment or other sanctions.”³⁷

Similarly, another finding asserts that such waiver demands and other tactics encroach on the constitutional rights and other legal protections of employees.³⁸

The bill would prohibit federal lawyers and investigators from requesting that an organization waive its attorney-client privilege or work product doctrine, although it would permit them to seek materials that they reasonably believe are not privileged. It would also bar them from conditioning any charging decision or cooperation credit on waiver or non-waiver of privilege, the payment of an employee’s legal fees, the continued employment of a person under investigation, or the signing of a joint defense agreement.³⁹

On the other hand, the bill would permit companies to offer internal investigation materials to federal authorities voluntarily, provided that prosecutors do not solicit those materials.⁴⁰ The bill does not contain any penalties for violations of its provisions.

III. The McNulty Memo

On Dec. 12, less than one week after Specter introduced his bill, the Justice Department issued new guidelines to replace the Thompson memo. In a memorandum to DOJ personnel Deputy Attorney General McNulty applauded the agency’s “unprecedented success” in its prosecution of corporate fraud in the past four years and proclaimed that corporations increasingly recognize the need to self-police, self-report and cooperate with the government.⁴¹

While affirming that the DOJ’s fundamental principles guiding its enforcements effort are sound, McNulty explained the department’s rationale for revamping its guidelines. The new guidelines, he noted, address concerns raised by “responsible corporate officials” that the agency’s practices may be “discouraging full and candid

communications between corporate employees and legal counsel,” thereby hindering their ability to respond to a government investigation in a meaningful way.⁴² Noting that this result was never the intention of the corporate charging principles, he announced that an adjustment in certain aspects of the DOJ’s policies in the new guidelines would promote public confidence and encourage corporate-fraud prevention efforts.

The McNulty memo made several modifications to the Thompson memo’s guidelines regarding both privilege waivers and the advancement of attorney fees. First, it defines two different types of privileged information as “Category I” and “Category II” information.⁴³ Second, it imposes a more stringent procedure and approval process that federal prosecutors must follow before requesting a privilege waiver from a company.

Third, it forbids prosecutors from considering a company’s refusal to waive a privilege for Category II information in their charging assessments. Fourth, it prohibits prosecutors from taking into account a company’s advancement of attorney fees to employees in making charging decisions.

A. Category I and Category II Information

Unlike the Thompson memo, the McNulty memo specifically defines two types of privileged information by distinguishing between factual information and legal advice.⁴⁴ Category I covers “purely factual information” relating to the underlying misconduct that may or may not be privileged. It includes key documents, witness statements, purely factual interview memoranda regarding the underlying misconduct, organization charts prepared by company counsel, factual chronologies, factual summaries or reports containing investigative facts documented by counsel.⁴⁵

Category II is for “legal advice given to the corporation before, during and after the underlying misconduct occurred.” It includes the “production of attorney notes, memoranda or reports containing counsel’s mental impressions and conclusions, legal determinations reached as a result of an internal investigation, or legal advice given to the corporation.”⁴⁶ The categorization of privileged information is significant, as the McNulty memo sets forth different rules for each category.

B. Requests for Corporate Waivers of Category I Information

The McNulty memo imposes three new restrictions on the process by which prosecutors can seek a corporation’s waiver of attorney-client or work product protections for

Category I information. Prosecutors must first establish a “legitimate need” for the privileged information, seek the “least intrusive waiver necessary,” and obtain formal approval from both the local U.S. attorney and senior DOJ officials.⁴⁷

1. ‘Legitimate Need’

Prosecutors must show that there is a “legitimate need for the privileged information to fulfill their law enforcement obligations.”⁴⁸ A “legitimate need” for the information, however, is *not* established by concluding that it is merely desirable or convenient to obtain privileged information. Rather, the McNulty memo contemplates a process whereby there is a balancing of the policy considerations underlying the attorney-client privilege and work product doctrine with law enforcement’s needs in the investigation.⁴⁹

Whether there is a “legitimate need” will depend on four considerations:

- The likelihood and degree to which the privileged information will benefit the government’s investigation;
- Whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver;
- The completeness of the voluntary disclosure already provided; and
- The collateral consequences to a corporation of a waiver.⁵⁰

The McNulty memo, however, provides no guidance as to how the balancing process will occur or who will make the determination as to whether there has been a sufficient showing of a “legitimate need” for privileged information. Presumably, both the U.S. attorney of the district seeking the request and the assistant attorney general for the DOJ’s Criminal Division must conclude that there is a “legitimate need.”

2. The ‘Least Intrusive Waiver Necessary’

Once a determination that a “legitimate need” is made, prosecutors must seek the “least intrusive waiver necessary” to conduct a complete and thorough investigation. The McNulty memo instructs prosecutors to use a “step-by-step” approach to requesting information. In the first instance, prosecutors are guided to request “purely factual information,” which may or may not be privileged, relating to the underlying misconduct.⁵¹

3. Requisite Approvals

Prosecutors must submit a written request to the U.S. attorney before requesting a waiver for Category I information. That request must set forth law enforcement’s legitimate need for the information as well as identify the scope of the waiver sought. The U.S. attorney must then provide a copy of the prosecutor’s request to, and consult with, the assistant attorney general for the Criminal Division before granting or denying the request.

If the assistant attorney general approves the request, the U.S. attorney will provide written authorization that the prosecutor may seek a waiver. The U.S. attorney must then communicate the waiver request in writing to the corporation. Copies of all waiver requests and authorizations for Category I information must be maintained in the U.S. attorney’s files.⁵²

4. Consequences for Refusing to Provide Waivers for Category I Information

The McNulty memo mirrors the Thompson memo as to how it treats a corporation’s refusal to provide a waiver for Category I information. The memorandum plainly states, “A corporation’s response to the government’s request for waiver of privilege for Category I information *may be considered* in determining whether a corporation has cooperated in the government’s investigation.”⁵³ Thus, if a company refuses to waive its privileges as to Category I information, prosecutors can take that fact into account when making their charging decisions.

C. Requests for Corporate Waivers of Category II Information

By definition, Category II information has the potential to be more sensitive than Category I information since it includes legal advice given to the corporation before, during and after the underlying misconduct occurred. It can include counsel’s mental impressions and conclusions pertaining to salient events and applicable law.

The McNulty memo cautions prosecutors to seek Category II information only in rare circumstances. The new guidelines state that if a corporation produces Category I information, prosecutors can request a waiver for Category II information only if the purely factual information provides an incomplete basis to conduct a thorough investigation.⁵⁴

The approval process for corporate waivers of Category II information is similar to, but slightly different from, the process governing requests for waivers of Category I information. As to Category II information, the U.S. attorney must submit to the deputy attorney general a request for authorization to seek a waiver that includes law enforcement’s “legitimate need” for the information

and the scope of the waiver sought. The deputy attorney general must then provide the U.S. attorney with written authorization to request the waiver. The deputy attorney general must also maintain copies of each waiver request and authorization for Category II information. If the request is authorized, the U.S. attorney must communicate that request in writing to the corporation.⁵⁵

While prosecutors can consider a corporation's refusal to provide a waiver for Category I information, they are precluded from considering a company's declination to provide a waiver for Category II information against the company in making a charging decision.⁵⁶ Since the McNulty memo states that requests for Category II information should be sought only in "rare circumstances," there should be a small number of cases in which prosecutors are actually precluded from considering a corporation's refusal to waive its privileges in making charging decisions.

The McNulty memo arguably sets forth a more restrictive approach than the Thompson memo as to the type of information on which prosecutors are encouraged to seek a waiver. Under the Thompson memo, prosecutors were urged to seek waivers of not only factual information from internal investigations, but also "contemporaneous advice given to the corporation concerning the conduct at issue."⁵⁷

On the other hand, the McNulty memo treats all legal advice given to the corporation before, during and after the underlying misconduct occurred as Category II information, which should be rarely sought. This revision may prove to be significant since legal advice, as opposed to "purely factual information," may be deemed more sensitive. However, companies that waive the privilege as to Category I information run the risk of being deemed to have waived Category II information as to the same subject matter in future actions by third parties.⁵⁸

D. Requests for Special Categories of Privileged Information

Unlike the Thompson memo, the McNulty memo also addresses prosecutors' requests for waivers of legal advice where two special circumstances exist. The first involves situations in which either the corporation or an employee of the corporation relies on the advice-of-counsel defense. The second scenario pertains to legal advice or communications in furtherance of a crime or fraud that fall within the crime-fraud exception to the attorney-client privilege. In both instances the McNulty memo advises prosecutors to follow the authorization process established for requesting waiver of Category I information.⁵⁹

1. The Advice-of-Counsel Defense

The advice-of-counsel defense may apply in cases requiring proof that the defendant acted "willfully" or

with the knowledge that his or her conduct was unlawful,⁶⁰ which includes many white-collar crimes.⁶¹ Reliance on the advice of counsel is technically not a legal defense to a crime, but it can constitute evidence that a person acted in good faith and thereby did not have the requisite mental intent to commit a particular crime.

To establish good faith based on the advice of counsel, a defendant must demonstrate that he or she fully disclosed all material facts to counsel, relied in good faith on the advice given by counsel and acted in accordance with that advice.⁶² The defense is available regardless of whether the legal advice was rendered from in-house or outside counsel. The assertion of the advice-of-counsel defense, however, results in a waiver of the attorney-client privilege with respect to the subject matter on which the defense is based.⁶³

The McNulty memo classifies a request for a privilege waiver of legal advice when a company or an employee relies on the advice-of-counsel defense as a Category I request. This means that if a company refuses to waive its privilege, prosecutors can take that factor into account in their corporate charging decisions. As a practical matter, since a party asserting an advice-of-counsel defense will have to waive the attorney-client privilege at some point, this policy may not have a significant impact on the waiver issue.

2. The Crime-Fraud Exception

The attorney-client privilege does not prevent disclosure of communications by either a client or a lawyer for the purpose of committing a future crime or fraud.⁶⁴ This exemption is known as the crime-fraud exception to the attorney-client privilege. The exception does not apply to advice referring to prior misconduct, which is protected. Rather, it applies to future and ongoing wrongdoing, which is not protected.⁶⁵

While the McNulty memo references this issue in passing and with no discussion, it in fact has broad implications. In recent years, the Justice Department has escalated its focus on targeting lawyers and legal advice in white-collar criminal cases. To achieve that end, the agency has increasingly sought to pierce the attorney-client privilege by serving grand jury subpoenas and motions seeking discovery of privileged communications under the crime-fraud exception.

In such cases, a court often conducts an evidentiary hearing, at which the government bears the burden of proving that the crime-fraud exception applies.⁶⁶ In cases where the DOJ suspects that legal advice falls within the crime-fraud exception, prosecutors can now simply request a

privilege waiver. Since such information falls in Category I, prosecutors can consider a company's refusal to waive its privileges. In effect, the DOJ can exert pressure on a corporation to waive its privilege as to certain legal advice as a means to bypass a much more rigorous judicial process at which it has the burden of proof.

E. Shielding Culpable Employees and Agents

The McNulty memo also announces a retreat in the DOJ's prior position regarding a company's advancement of legal fees to officers, executives, employees and agents under investigation or indictment. Under the Thompson memo, prosecutors were permitted to consider whether a corporation advanced legal fees in making a charging decision.⁶⁷ The modified guidelines now state that prosecutors "generally should not take into account whether a corporation is advancing attorney fees to employees or agents under investigation and indictment." The McNulty memo acknowledges that a corporation's compliance with governing state law and its contractual obligations cannot be deemed a failure to cooperate.⁶⁸

The McNulty memo provides an exception permitting prosecutors to take into account a company's advancement of attorney fees in "extremely rare cases" in which the totality of the circumstances show that the advancement was intended to impede a criminal investigation. In those "extremely rare cases," prosecutors must obtain the approval of the deputy attorney general before they can consider this factor in a charging decision. Prosecutors remain entitled to ask questions about an attorney's representation of a corporation or its employees, such as how and by whom the attorney's fees are paid.⁶⁹ And the vagueness of the DOJ's use of the terms "generally" and "extremely rare cases" makes it difficult for companies to know what to do.

IV. Comments on the New Guidelines

A. The New Privilege Waiver Rules

The Justice Department's new corporate charging principles will likely have little impact on how companies respond to federal criminal investigations or prosecutions. While the tone of the McNulty memo is considerably less harsh than that of the Thompson memo, the substance of the modified guidelines leaves most of the prior principles substantially unchanged.

The principal flaw of the McNulty memo is that it continues to permit prosecutors to condition cooperation on a company's willingness to waive its attorney-client privilege and work product protection. The new guidelines' distinction between Category I and Category II information will

not change this outcome, although it should minimize requests for waivers of sensitive legal advice given to the corporation contemporaneously with the conduct in question.

While prosecutors cannot take into account an organization's refusal to waive its privileges as to Category II information, Category II information will probably represent a small subset of the privileged information that prosecutors will request. The leverage that the government now has when requesting a privilege waiver is no different than under the Thompson memo. Corporations will still feel compelled to waive their privileges or face the dire consequences of an indictment.

There remains the realistic specter that third parties in future actions will assert that a corporation's waiver of its privileges as to Category I information constitutes a complete waiver of all privileged communications on the subject matter, including legal advice falling within Category II. Whether a waiver of a privilege with respect to factual information (Category I) effectuates a subject matter waiver encompassing legal advice (Category II) is governed by state and federal law on privilege, which is not superseded by DOJ fiat in the form of a policy memo or otherwise.

Thus, corporations that comply with a privilege waiver request for Category I information should anticipate and expect that copycat civil class actions will be filed in the wake of publicity surrounding the federal investigation. Ironically, if private plaintiffs in those cases prevail in obtaining court orders compelling production of Category II information, it is likely that such sensitive information will become publicly available, including to the DOJ. In essence, compliance with the McNulty memo's new privilege classification system could result in the evisceration of the line drawn between Category I and Category II information.

Perhaps the most significant impact of the McNulty memo will be the Justice Department's internal screening of privilege waiver requests. Presumably, prosecutors will now have to prepare a memorandum detailing why there is a "legitimate need" for the privileged information. Although the McNulty memo provides sparse guidance as to the mechanics of the so-called "balancing process" to be deployed, it appears that both the local U.S. attorney and the assistant attorney general for the Criminal Division must determine that there is a "legitimate need."

Theoretically, this new, more stringent approval process should result in fewer privilege waiver requests and weed out those where no true need exists. But the McNulty memo does not permit corporate input into this pro-

cess, even though one of the key factors in the analysis is the “collateral consequences to [the] corporation of a waiver.”⁷⁰ If the company is excluded from the process, there is simply no assurance that a proper balancing of interests will occur.

B. The McNulty Memo and Proposed Rule 502(c)

In April 2006 the Advisory Committee on Evidence Rules approved a proposed amendment to the Federal Rules of Evidence, which attempts to address some concerns raised by the McNulty memo’s waiver provisions. The proposed rule, Rule 502(c), titled “selective waiver,” provides:

In a federal or state proceeding, a disclosure of a communication or information covered by the attorney-client privilege or work product protection — when made to a federal public office or agency in the exercise of its regulatory, investigative or enforcement authority — does not operate as a waiver of the privilege or protection in favor of non-governmental persons or entities. The effect of disclosure to a state or local government agency, with respect to non-governmental persons or entities, is governed by applicable state law. Nothing in this rule limits or expands the authority of a government agency to disclose communications or information to other government agencies or as otherwise authorized or required by law.

The rationale of the proposed rule is that the discovery process will be more efficient and less costly if individuals and companies can produce documents to the government without the risk of a subject matter waiver of the attorney-client privilege or work product protection.⁷¹

While the proposed rule would provide some additional protection to corporations, it still has significant shortcomings. Commenting on the proposed rule, Lawyers for Civil Justice cites several persuasive reasons why it fails to adequately protect corporations against the disclosure of privileged information.

First, Rule 502(c) “does not apply to state or local government agencies and does not restrict the right of any government agency to disclose private materials to other government agencies or to Congress.”

Second, it “allows state and local law enforcement and regulatory authorities to receive privileged materials produced to federal authorities.” Third, the proposed rule does not limit the use of privileged documents by a governmental agency.

Lawyers for Civil Justice maintains that government regulators and investigators will treat the selective-waiver provision “as a standing request for defendants to disclose protected information and [corporations] will presume that, given the selective-waiver provision, [they] have no legitimate reason to withhold such information.”⁷² Thus, proposed Rule 502(c), as currently drafted, does not eliminate the problems that a corporation faces when responding to a waiver request under the McNulty memo.

C. The New Advancement-of-Fees Rule

The McNulty memo’s clarification of the DOJ’s principles governing the advancement of attorney fees is a step in the right direction. Under the revised policy, absent extraordinary circumstances, prosecutors cannot consider a company’s advancement of legal fees to its employees under investigation in the decision as to whether to charge the corporation. This revision appears to codify the court’s ruling in *Stein*.

The DOJ may have abandoned its prior principles governing the consideration of the advancement of legal fees to avoid intense evidentiary hearings of possible governmental misconduct, like the hearing held in *Stein*. There, federal prosecutors were required to testify, and defense counsel obtained discovery of prosecutors’ and agents’ notes.⁷³ Under the new rules, it is unlikely that such a detailed probe of the government’s actions will occur in most cases.

Other aspects of the McNulty memo’s treatment of a company’s retention of employees, however, remain objectionable.

The new guidelines permit prosecutors to consider whether the corporation appears to be protecting culpable employees. And in their charging decisions, prosecutors may consider whether the corporation has retained employees without sanction for misconduct and whether it is providing employees with information about the government’s investigation under a joint defense agreement.⁷⁴

Yet the McNulty memo provides no standards for defining and determining who is culpable. Typically, the government decides employee culpability well before there is a judicial determination of the issue and usually long before seeking an indictment.

This practice places organizations in the untenable position of firing employees whom the government believes are guilty or risking being labeled uncooperative in an investigation or prosecution.⁷⁵

The timing of the Justice Department's issuance of the new guidelines likely was driven by judicial and legislative forces rather than the agency's avowed purpose of addressing legitimate concerns raised by corporate America.

The DOJ announced its new guidelines within days of Specter's introduction of the Attorney-Client Privilege Protection Act in December. If the bill is enacted, it will preclude governmental agencies from requesting privilege waivers.

There remains a fundamental philosophical difference between the DOJ and those who maintain that requiring a privilege waiver to avoid prosecution is never appropriate. It appears that the agency's latest pronouncement will be on a collision course with Specter's proposed legislation in early 2007.

Notes

¹ 15 U.S.C. §§ 77-80, 7201, 7211-18, 7232-34, 7241-46, 7262-66; 18 U.S.C. §§ 1341, 1343, 1349-1350, 1501, 1512-14, 1519, 1520; 28 U.S.C. §§ 994, 1658; 29 U.S.C. §§ 1021, 1131-32; P.L. 107-204 (2002).

² See Memorandum from Attorney General John Ashcroft to All Federal Prosecutors, Department Policy Concerning Charging Criminal Offenses, Disposition of Charges and Sentencing (Sept. 22, 2003), available at www.usdoj.gov/opa/pr/2003/September/03_ag_516.htm.

³ In January 2002 Arthur Andersen revealed that it had destroyed a substantial number of documents related to Enron. In March 2002 the DOJ brought obstruction-of-justice charges against Andersen for destroying the documents. In April and May of that year Andersen began to break up, as many partners and employees took positions elsewhere. By the end of May 2002 Andersen had largely dissolved. The firm's trial began later that month, resulting in a conviction in June 2002. Ironically, long after Andersen's demise the U.S. Supreme Court vacated the conviction and remanded the case for a new trial. See *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005).

⁴ Memorandum from Larry D. Thompson, Deputy Attorney General, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), available at www.usdoj.gov/dag/cftf/corporate_guidelines.htm. The origin of the Thompson memo was a previous memorandum on federal prosecution of corporations issued in 1999 by Thompson's predecessor, Eric H. Holder Jr. See Memorandum from Eric H. Holder Jr., Deputy Attorney General, Federal Prosecution of Corporations (June 16, 1999), available at <http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html>. The Holder memo was the DOJ's first official policy for the prosecution of businesses. Its general policy was that "[c]orporations should not be treated leniently because of their artificial nature" and that the prosecution of corporations can result in "great benefits for law enforcement and the public, particularly in the area of white-collar crime."

⁵ Thompson memo, *supra* note 4, at cover page.

⁶ U.S. DEP'T OF JUSTICE, CRIMINAL RESOURCE MANUAL § 163 (Supp. 2006) ("The Thompson memorandum sets forth nine factors that federal prosecutors must consider in determining whether to charge a corporation or other business organization.").

⁷ Thompson memo, *supra* note 4, at 3.

⁸ *Id.* at 7.

⁹ *Id.* See Interview with U.S. Attorney James B. Comey Regarding the Department of Justice's Policy on Requesting Corporations Under Criminal Investigation to Waive the Attorney-Client Privilege and Work Product Protection, U.S. ATT'YS BULL., at 1-8 (November 2003).

¹⁰ Thompson memo, *supra* note 4, at 7 n.3.

¹¹ *Id.*

¹² *Id.* at 7-8.

¹³ *Id.* at 8 n.4.

¹⁴ See Comey interview, *supra* note 9, at 1.

¹⁵ The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations: Hearing Before the Senate Judiciary Committee, 109th Cong. (Sept. 12, 2006) (statement of Karen J. Mathis, President, American Bar Association), available at http://www.abanet.org/poladv/letters/attyclient/060912testimony_mathis-acpriv.pdf. *The Decline of the Attorney Client Privilege in the Corporate Context: Survey Results*, ASS'N OF CORP. COUNSEL (2006) at 3, available at www.acca.com/Surveys/attyclient2.pdf (noting that as of last year, about 75 percent of in-house and outside corporate counsel agree in the existence of a corporate culture of waiver).

¹⁶ Letter From Former Senior Justice Department Officials to the Hon. Alberto Gonzales, Attorney General (Sept. 5, 2006), available at www.abanet.org/media/docs/ag_sept52006.pdf. Corporate personnel's actions may be influenced by the events involved in the recent indictment of Computer Associates' former CEO, Sanjay Kumar. According to the indictment, Kumar was interviewed by the company's outside counsel and asked questions about Computer Associates' accounting practices. *United States v. Kumar et al.*, No. 04-CR-00846-ILG, indictment filed (E.D.N.Y. Sept. 20, 2004). Kumar, who knew that the company was cooperating and was going to provide information to the government, allegedly made false statements during interviews. Company counsel provided the results of the interviews to the government. The government subsequently charged Kumar with conspiracy to obstruct justice and obstruction of justice.

¹⁷ Gonzales letter, *supra* note 16, at 2.

¹⁸ See Mathis statement, *supra* note 15, at 13.

¹⁹ *Id.*

²⁰ Gonzales letter, *supra* note 16, at 3. Letter from Michael S. Greco, ABA President, to the Hon. Alberto Gonzales, Attorney General (May 2, 2006), 2-3, available at www.abanet.org/poladv/letters/attyclient/060502letter_acprivgonz.pdf.

²¹ Letter from the Department of Justice to Michael S. Greco, ABA President (July 18, 2006), available at www.abanet.org/poladv/priorities/acpriv/doj-ltr71806.pdf.

²² See *United States v. Stein*, 435 F. Supp. 2d 330 (S.D.N.Y. 2006); *United States v. Stein*, 440 F. Supp. 2d 315 (S.D.N.Y. 2006), appeal docketed, No. 06-3999 (2d Cir. Aug. 25, 2006).

²³ *Stein*, 435 F. Supp. 2d at 356-73.

²⁴ *Id.* at 352-53. The court declined to dismiss the indictment, but ruled that KPMG could either voluntarily agree to pay the defendants' defense costs or the defendants could file a civil complaint against the firm within 14 days requesting a summary proceeding in which the court could order KPMG to advance the fees. *Id.* at 379.

²⁵ *Stein*, 440 F. Supp. 2d at 337-38.

²⁶ *Id.* at 331-33.

²⁷ *Id.* at 337.

²⁸ See Independence of the Legal Profession: Federal Governmental Policies on Privilege Waiver, American Bar Association, last updated Oct. 19, 2006, www.abanet.org/poladv/priorities/privilege-waiver.html.

²⁹ The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations, Hearing Before the Senate Judiciary Committee, 109th Cong. (2006) (statement of Edwin Meese III, Ronald Reagan Distinguished Fellow in Public Policy, Chairman, Center for Legal and Judicial Studies, The Heritage Foundation), available at www.heritage.org/Research/LegalIssues/tst091206a.cfm.

³⁰ *Id.* at 6.

³¹ The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations, Before the Senate Judiciary Committee, 109th Cong. (2006) (statement of Paul J. McNulty, Deputy Attorney General, U.S. Department of Justice).

³² *Id.*

³³ *Id.* at 6.

³⁴ Attorney-Client Privilege Protection Act of 2006, S. 30, 109th Cong. (2006).

³⁵ Attorney-Client Privilege Protection Act of 2007, S. 186, 110th Cong. (2007). *Attorney-Client Privilege — Sen. Specter Continues Efforts to Force DOJ to Stop Seeking Corporate Waiver of Privilege*, WHITE-COLLAR CRIMINAL REP., Jan. 19, 2007 (noting that the new bill is identical to the 2006 version).

³⁶ Attorney-Client Privilege Protection Act of 2006, *supra* note 34, at Section 2(b).

³⁷ *Id.* at Sections 2(a)(6), (8).

³⁸ *Id.*

³⁹ *Id.* at Section 3.

⁴⁰ Press Release, U.S. Senate Judiciary Committee, Specter Introduces Attorney-Client Privilege Protection Act of 2006 (Dec. 7, 2006).

⁴¹ Memorandum from Paul J. McNulty, Deputy Attorney General, to Heads of Department Components and U.S. Attorneys (Dec. 12, 2006) at cover page, available at www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.

⁴² *Id.*

⁴³ *Id.* at 9-10.

⁴⁴ As noted, the Thompson memo encouraged prosecutors to seek waivers of "the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue." Thompson memo, *supra* note 4, at 7 n.3. On the other hand, it counseled against seeking waivers of communications and work product related to advice concerning the government's criminal investigation, except in unusual circumstances. *Id.*

⁴⁵ McNulty memo, *supra* note 41, at 9.

⁴⁶ *Id.* at 10.

⁴⁷ *Id.* at 8-9.

⁴⁸ *Id.*

⁴⁹ *Id.* at 9.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.* (emphasis added).

⁵⁴ *Id.* at 10.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ Thompson memo, *supra* note 4, at 7 n.3.

⁵⁸ See generally Grace Carter and Eve Coddon, *Selective Waiver Fails Again — The 10th Circuit's Decision in Qwest Communications*, 21 WHITE-COLLAR CRIME L. REP. 1, Sept. 28, 2006.

⁵⁹ McNulty memo, *supra* note 41, at 12.

⁶⁰ See *United States v. Dockray*, 943 F.2d 152, 155 (1st Cir. 1991) (noting that good faith is an absolute defense to a mail or wire fraud charge).

⁶¹ This generalization encompasses conspiracy, 18 U.S.C. § 371; mail fraud, 18 U.S.C. § 1341; wire fraud, 18 U.S.C. § 1343; bank fraud, 18 U.S.C. § 1014; false claims, 18 U.S.C. § 287; securities fraud, 15 U.S.C. § 78j(b), and other statutes. *United States v. Bishop*, 291 F.3d 1100, 1106 (9th Cir. 2002) (willfulness is an element of conspiracy to defraud the United States); *United States v. Crooks*, 804 F.2d 1441, 1448 (9th Cir. 1986) ("willful" requires proof of specific intent to do something that the law forbids).

⁶² See *United States v. McClatchey*, 217 F.3d 823, 832 (10th Cir. 2000).

⁶³ See *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 685 (1st Cir. 1997).

⁶⁴ See *United States v. Zolin*, 491 U.S. 554, 562-63 (1989).

⁶⁵ *Id.*

⁶⁶ See *United States v. Chen*, 99 F.3d 1495, 1503 (9th Cir. 1996); *In re Grand Jury Investigation*, 842 F.2d 1223, 1226 (11th Cir. 1987); *In re Grand Jury Proceedings*, 183 F.3d 71, 78 (1st Cir. 1999).

⁶⁷ Thompson memo, *supra* note 4, at 7-8.

⁶⁸ McNulty memo, *supra* note 41, at 11.

⁶⁹ *Id.* at n.3, 11-12, n.4.

⁷⁰ *Id.* at 9.

⁷¹ See Letter from Hon. Jerry E. Smith, Chair, Advisory Committee on Evidence Rules, to Hon. David F. Levi, Chair, Standing Committee on Rules of Practice and Procedure (revised July 30, 2006), at 1-2.

⁷² Lawyers for Civil Justice, Comments to the Advisory Committee on Evidence Rules of the U.S. Judicial Conference (Jan. 5, 2007) at 5, 19, available at [lcj.digitalbay.net/documents/LCJ%20Comments%20RE%20502%20Final%2010507%20no%20cover.pdf](http://lcy.digitalbay.net/documents/LCJ%20Comments%20RE%20502%20Final%2010507%20no%20cover.pdf).

⁷³ As in *Stein*, other defendants have filed motions to dismiss indictments asserting that the government's application of the Thompson memo improperly caused their employers to terminate advancement of their legal fees. See *United States v. Urciuoli*, No. CR 06-02-01-T (D.R.I. 2006), and *United States v. Shanahan*, No. 1:04-CR-00126-PB-5 (D.N.H. 2004).

⁷⁴ See McNulty memo, *supra* note 41, at 11.

⁷⁵ The ABA, a critic of the McNulty memo, maintains that the new guidelines fail to protect employees' legal rights because they still "allow prosecutors to force companies to take punitive actions against their employees in some cases in return for cooperation credit, long before any guilt is established." Martha Neil, *Thompson Memo Changes Not Enough, ABA Says*, ABA JOURNAL E-REPORT, Dec. 15, 2006, <http://www.abanet.org/journal/redesign/d18specter.html>.

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